No. 13220

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

CARMELO J. PELLEGRINO,

Appellant,

vs.

WILLIAM D. NESBIT, HUGH F. COLVIN, JAMES R. BRADBURN and CONSOLIDATED ENGINEERING CORPORATION,

Appellees.

APPELLANT'S OPENING BRIEF.

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FILED

MAR 29 1952

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Parker & Company, Law Printers, Los Angeles. Phone MA. 6-9171.

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Appellees.

APPELLANT'S OPENING BRIEF.

Statement.

Appellant, Pellegrino, has appealed from a final order of the District Court of the United States, Southern District of California, Central Division, entered November 29, 1951, denying his motion for leave to intervene as plaintiff for the purpose of appealing from judgments made and entered October 30, 1951, in favor of each of the named individual appellees herein. [R. p. 118.]

Facts.

Appellant, Pellegrino, is and has been a stockholder of Consolidated Engineering Corporation (hereinafter referred to as Consolidated) since September 11, 1950. [R. p. 112.] In October, 1950, appellant, through his attorney, requested Consolidated to institute suit as contemplated by Section 16(b) of the Securities Exchange Act of 1934,* to recover the profits realized by appellees, Hugh F. Colvin, James R. Bradburn and William D. Nesbit, who were officers and/or directors of the corporation, as a result of their respective purchases and sales of Consolidated's common stock within periods of less than six months. [R. p. 113.] The said letter informed Consolidated that in the event it did not institute such suit within sixty (60) days, appellant would commence such action on its behalf in accordance with the provisions of Section 16(b) of the Act. [R. p. 113.] Thereafter appellant's attorney was advised by Consolidated that it had instituted suit against appellees, Bradburn, Nesbit and Colvin, for the recovery of "short swing" profits. [R. p. 114.] By letter dated October 29, 1951, counsel for Consolidated informed appellant's attorney that the District Court had rendered its opinion dismissing the complaints as against each of the defendants-appellees herein. [R. p. 114.] Judgments were made and entered thereon on October 30, 1951. [R. pp. 91-92, 99-100, 108-109.] Thereafter, by letter dated No-

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*See *infra,* page 4.

vember 15, 1951, counsel for Consolidated informed appellant's attorney that the Board of Directors of Consolidated had decided not to take an appeal from the judgments. [R. pp. 114-115.] Appellant was thereafter advised by his attorney that after careful study he was of the opinion that the District Court had erred in granting judgments for defendants-appellees in each of the cases. Appellant thereupon instructed his attorney to take the steps necessary to permit him, as a stockholder of Consolidated, to appeal from the judgments aforesaid. [R. pp. 114-115.]

Thereafter appellant, through his attorneys, made a motion for leave to intervene as plaintiff for the purpose of appealing from the judgments. [R. pp. 109-116.]

This motion, heard before the same District Judge who had granted the judgments for the defendants-appellees, was denied by order dated November 29, 1951. [R. pp. 117-118.]

Appellant thereupon filed his Notice of Appeal from this order. [R. p. 118.]

Issues Presented.

1. Did the District Court err in denying appellant stockholder's motion to intervene as plaintiff for the purpose of appealing from the judgments for defendants-appellees?

2. Did the District Court err in granting judgments in favor of the respective individual defendants-appellees herein?

POINT I.

The District Court Erred in Denying Appellant's Motion to Intervene as Plaintiff for the Purpose of Appealing From the Judgments Against the Corporation and in Favor of the Individual Defendants-Appellees Herein.

Section 16(b) of the Securities Exchange Act of 1934, 15 U. S. C. A., Section 78p(b), provides as follows:

> "For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months, Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale

> and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection."

Thus, Section 16(b) of the Act, *supra,* conferred an absolute right upon appellant, as a stockholder of Consolidated, to institute suit in its behalf to recover the "short swing" profits realized by the individual defendants-appellees herein provided, (1) Consolidated should "fail or refuse to bring such suit within sixty days after request," or (2) Consolidated should "fail diligently to prosecute the same thereafter."

Although Consolidated did institute such suits within sixty days after appellant's request, it has wholly failed and refused to prosecute an appeal from the judgments made against the corporation and in favor of the individual defendants-appellees.

In *Steinberg v. Sharpe* (S. D.-N. Y., 1950), 95 Fed. Supp. 32, aff'd (C. A. 2, 1951), 190 F. 2d 82, the facts were practically identical with those involved in the complaints by Consolidated against the individual defendants-appellees herein. In that case, the United States Court of Appeals affirmed Judge Medina's summary judgment against the defendant directing him to pay back to the corporation all the "short swing" profits which he had realized.

Thus, in the exercise of reasonable diligence, Consolidated should have appealed from the District Court's judgments made against it and in favor of the defendants-appellees. Its failure to do so certainly demonstrates that, after commencing the actions pursuant to

appellant's request, it has failed "diligently to prosecute the same thereafter."

Accordingly, appellant's motion to intervene for the purpose of prosecuting an appeal from the judgments aforesaid should have been granted *as a matter of right.*

As a stockholder of Consolidated, appellant has a substantial interest in the subject matter of these actions and will be bound by the final judgments and ultimate determinations thereof.

Rule 24(a)(2) of the Federal Rules of Civil Procedure provides as follows:

> "(a) Intervention of Right. Upon timely application anyone shall be permitted to intervene in an action: * * * (2) when the representation of the applicant's interest by existing parties is or may be inadequate and the applicant is or may be bound by a judgment in the action; * * *."

In clarifying the aforesaid Rule the following is stated in 4 Moore's Federal Procedure at pages 38, 39:

> "* * * Inadequacy of representation is shown * * * if the representative * * * fails because of non feasance in his duty of representation. * * *."

It is a cardinal principle of law that the Board of Directors of a corporation is the representative of its stockholders. It is the duty of the Board to protect and foster the interests of the corporation and its stockholders.

The Board of Consolidated, in failing and refusing to appeal from the aforesaid judgments, especially in view of the appellate court decision in *Steinberg v. Sharpe, supra,* was "non feasant" in its duty of representation. Appellant should, therefore, as a matter of right, have

been permitted to intervene for the purpose of appealing from the judgments.

The inadequacy of representation can further be demonstrated by the fact that since the three individual defendants-appellees herein were appointed as officers of Consolidated by its Board of Directors, this Board could hardly be expected to zealously prosecute any action against them.

This case is on all fours with *Park & Tilford, Inc. v. Schulte* (C. A. 2, 1947), 160 F. 2d 984, Cert. den., 332 U. S. 761. In that case *Park & Tilford, Inc.,* commenced an action under Section 16(b) of the Securities Exchange Act of 1934 to recover "short swing" profits realized by certain of its principal stockholders. Kogan, a stockholder of Park & Tilford, Inc., made a motion to intervene in the suit. The District Court denied this motion. Thereafter the District Court granted a judgment in favor of Park & Tilford, Inc., which Kogan deemed insufficient as a matter of law. Park & Tilford, Inc., refused to appeal from this judgment and Kogan thereupon appealed to the United States Court of Appeals from the District Court's order denying his motion to intervene.

The United States Court of Appeals, in reversing the order of the District Court and permitting Kogan to intervene for the purpose of appealing from the judgment, also decided Kogan's appeal from the judgment at the same time, stating (pp. 988, 989):

> "With reference to Kogan's application to intervene below, we think, as we have indicated in allowing her to intervene here, that the interests of minority shareholders were not adequately represented by

existing parties to the action. Under the circumstances here disclosed, the interests represented by defendants and their father were so dominant in the affairs of plaintiff that the District Court should have allowed stockholder representation to guard against even the appearance of any concerted action. As it turns out, plaintiff was at least ill-advised to concede the higher amount as the purchase price and to reduce its demand for judgment from an original $500,000 to the amount actually awarded below. But viewing this only as an error of judgment and disregarding Kogan's claims of a speculatively rigged market, *we still have an ample demonstration that the representation was inadequate and intervention should have been granted under Federal Rules of Civil Procedure, rule 24(a)(2), 28 U. S. C. A. following section 723c.* Mack v. Passaic Nat. Bank & Trust Co., 3 Cir., 150 F. 2d 474, 477; United States v. C. M. Lane Lifeboat Co. D. C. E. D. N. Y., 25 F. Supp. 410, affirmed 2 Cir., 118 F. 2d 793, appeal dismissed, C. M. Lane Lifeboat Co. v. United States, 314 U. S. 579, 62 S. Ct. 124, 86 L. Ed. 469; 2 Moore's Federal Practice, Sect. 24.07, page 2333. *This right may be protected by appeal to this Court.* United States v. Philips, 8 Cir., 107 F. 824; United States Trust Co. of New York v. Chicago Terminal Transfer R. Co., 7 Cir., 188 F. 292, 296; 2 Moore's Federal Practice, Sect. 24.06, page 2332. On remand the stockholder is entitled to ask for counsel fees payable out of the fund recovered. Smolowe v. Delendo Corporation, *supra,* 2 Cir., 136 F. 2d 231, 241.

"The order denying intervention to Kogan is reversed, the judgment is vacated, and the action is remanded to the District Court for the award of a judgment for $418,128.59 with interest and costs

> against the defendants, together with an allowance of counsel fees from the fund recovered found appropriate by the Court. Costs in this Court will be taxed against the defendants." (Italics supplied.)

While appellant's interest is only derivative, it is no less real than a direct interest and will justify intervention. See *Bronson v. La Cross and M. R. Co.* (1864), 2 Wall. 283; *Klein v. Nu-Way Shoe Co.* (C. A. 2, 1943), 136 F. 2d 986; *Galconda Petroleum Corp. v. Petrol Corp.* (S. D. Cal., 1942), 46 Fed. Supp. 23.

In *Wolpe v. Poretsky* (C. A. D. C., 1944), 144 F. 2d 505, 508, cert. den. 323 U. S. 777, the Court stated:

> "The application to intervene was timely. Intervention may be allowed after a final decree where it is necessary to preserve some right which cannot otherwise be protected. *Here at least one of the rights which cannot be protected without intervention is the right to appeal.* The Court was, therefore, in error in denying appellants leave to intervene *as a matter of right*" (Emphasis supplied.)

And in *United States Casualty Co. v. Taylor* (C. A. 4, 1933), 64 F. 2d 521, 527, the Court said:

> "* * * Equity Rule 37 (28 U. S. C. Sect. 723) above quoted, declares that intervention may be permitted at any time, and the decisions show that it may be allowed after a final decree when it is necessary to do so to preserve some right which cannot otherwise be protected. United States v. Securities Co. (C. C.) 128 F. 808, 810; Cincinnati I. & W. R. Co. v. Indianapolis Union Ry. Co. (C. C. A.) 279 F. 356, 363."

It is respectfully submitted that the District Court's denial of appellant's motion to intervene in the actions was as effective to foreclose any right of appeal from its judgments as though no such rights ever existed. Yet, appellant and the other stockholders of Consolidated will be bound by these judgments.

The Supreme Court in *Brotherhood of Railroad Trainmen v. Baltimore & O. R. Co.* (1947), 331 U. S. 519, recognized the inviolate rights of appeal from judgments, when it stated at page 524:

> "* * * But where a statute *or the practical necessities* grant the applicant an absolute right to intervene, the order denying intervention becomes appealable. Then it may fairly be said that the applicant is adversely affected by the denial, there being no other way in which he can better assert the particular interest which warrants intervention in this instance. *And since he cannot appeal from any subsequent order or judgment in the proceeding unless he does intervene, the order denying intervention has the degree of definiteness which supports an appeal therefrom.* See Missouri-Kansas Pipe Line Co. v. United States, 312 U. S. 502, 508, 85 L. Ed. 975, 981, 61 S. Ct. 666." (Emphasis supplied.)

And in *Dickinson v. Petroleum Conv. Corp.* (1950), 338 U. S. 507, 513, the Court held that "an order denying intervention to a person having an absolute right to intervene is final and appealable."

It is respectfully submitted that the District Court erred in denying appellant's motion to intervene in the actions for the purpose of appealing from its judgments.

POINT II.

The District Court Erred in Granting Judgments Against Consolidated Engineering Corporation and in Favor of Each of the Individual Defendants-Appellees Herein.

The incontrovertible facts show that, pursuant to option agreements, Consolidated granted each of the individual appellees herein the right to purchase 5,000 shares, respectively, of its common stock, in blocks of 1000 shares each, at $5.00 per share, during a period of five years, so long as he remained in the corporation's employ. [R. pp. 12, 21-25, 36, 44-48, 59, 69-73.]

Under each of the agreements, the option granted thereby became exercisable as to the first block one year from the date of the agreement, as to the second block two years from such date, as to the third block three years from such date, as to the fourth block four years from such date and as to the fifth block five years from such date. [R. pp. 22, 45, 70.]

Each of the individual appellees herein, while an officer of Consolidated, purchased shares of its common stock under his respective option agreement and, within a period of less than six months thereafter, sold shares of Consolidated common stock at a price in excess of the option price. [R. pp. 5, 12-15, 29, 36-39, 52, 59-64.]

Consolidated commenced suit against each of the individual appellees herein, pursuant to Section 16(b) of the Securities Exchange Act of 1934, to recover the profits realized as a result of their respective "short swing" transactions in its stock. [R. pp. 3-6, 27-30, 50-53.]

The District Court granted judgments in favor of each of the individual appellees herein, stating in its opinion [R. 80-81, 102 Fed. Supp. 112]:

> "There is no contention here that defendants in any way unfairly used information which they might have obtained as officers, directors or beneficial owners. * * * Inasmuch as option agreements had been given to sixteen employees, it would seem entirely unfair to impose a penalty upon the three defendants herein, when it is impossible to impose a like penalty upon the other key employees who did and performed the same acts as complained of in these actions but who did not happen to have conventional titles of 'corporation officials.'
>
> "The sole excuse for filing these actions was that defendants were 'officers' of the corporation. Defendant Bradburn was vice-president, in charge of engineering; defendant Nesbit was vice-president, in charge of production, and defendant Colvin was treasurer. Because the other employees who had similar option agreements did not happen to be officers or directors of the corporation, they could exercise their options to purchase, and sell with immunity. It would be extremely inequitable to penalize these three who held options and not similarly penalize the others. According to the section, its purpose is to 'prevent unfair use of information.' There is no imputation that these defendants or any of them unfairly used any information obtained through their relationship to plaintiff corporation."

It is respectfully submitted that recovery under Section 16(b) of the Securities Exchange Act of 1934 does not require any showing that the individual appellees actually

obtained information by reason of their inside position, or made unfair use of any information so obtained.

Thus in *Smolowe v. Delendo Corporation* (C. A. 2, 1943), 136 F. 2d 231, although it was conceded that defendant had made no use of inside information in his "short swing" transactions, the Court of Appeals affirmed the judgment of the District Court directing the defendant to pay back such profits to the corporation, stating (pp. 235, 236):

> "The controversy as to the construction of the statute involves both the matter of substantive liability and the method of computing 'such profit.' The first turns primarily upon the preamble, viz. 'For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer.' Defendants would make it the controlling grant and limitation of authority of the entire section, and liability would result only for profits from a proved unfair use of inside information. *We cannot agree with this interpretation.*
>
> * * * * * * * *
>
> "The primary purpose of the Securities Exchange Act—as the declaration of policy in Section 2, 15 U. S. C. A. Sect. 78b, makes plain—was to insure a fair and honest market, that is, one which would reflect on evaluation of securities in the light of all available and pertinent data. Furthermore, the Congressional hearings indicate that Section 16(b), specifically, was designed to protect the 'outside' stockholders against at least short-swing speculation by insiders with advance information. It is apparent too, from the language of Section 16(b) itself, as well as from the Congressional hearings, that the

only remedy which its framers deemed effective for this reform was the imposition of a liability based upon an objective measure of proof. This is graphically stated in the testimony of Mr. Corcoran, chief spokesman for the draftsmen and proponents of the Act, in Hearings before the Committee on Banking and Currency on S. 84, 72d Cong., 2d Sess., and S. 56 and S. 97, 73d Cong., 1st and 2d Sess., 1934, 6557: *'You hold the director, irrespective* of any intention or expectation to sell the security within six months after, because it will be absolutely impossible to prove the existence of such intention or expectation, and you have to have this crude rule of thumb, because you cannot undertake the burden of having to prove that the director intended, **at the** time he bought, to get out on a short swing.'

* * * * * * * *

*"Had Congress intended that only profits from an actual misuse of inside information should be recoverable, it would have been simple enough to say so. Significantly, however, it makes recoverable the profit from any purchase and sale, or sale and purchase within the period. The failure to limit the recovery to profits gained from misuse of information justifies the conclusion that the preamble was inserted for other purposes than as a restriction on the scope of the act. * * *"* (Emphasis supplied.)

And in *Gratz v. Claughton* (C. A. 2, 1951), 187 F. 2d 46, 50, cert. den., 341 U. S. 920, the Court of Appeals in affirming the District Court's judgment against the defendant, stated:

"* * * If only those persons were liable, who could be proved to have a bargaining advantage, the execution of the Statute would be so encum-

bered as to defeat its whole purpose. We do not mean that the interest, of which a statute deprives an individual, may never be so vital that he must not be given a trial of his personal guilt; but that is not so when all that is at stake is a director's, officer's or 'beneficial owner's' privilege to add to, or subtract from, his holdings for a period of six months. In such situations it is well settled that a statute may provide any means which can reasonably be thought necessary to deal with the evil, *even though it may cover instances where it is not present.* * * *" (Emphasis supplied.)

The basis for the District Court in granting judgments in favor of the individual appellees herein is set forth in that Court's opinion [R. pp. 80-81], wherein it was stated that "it would seem entirely unfair" and "extremely inequitable to penalize these three" individual appellees because they "were 'officers' of the corporation" when "it is impossible to impose a like penalty upon other key employees" who were not officers or directors of the corporation but "had similar option agreements" and "could exercise their options to purchase, and sell with immunity."

It is respectfully submitted that the District Court apparently misconstrued the clear language in Section 16(b) of the Act and the legislative purpose and intent of Congress which enacted it.

The Act is wholly unconcerned with the fairness of any particular transaction. Its sole purpose is to deter any officer, director or "beneficial owner" of an issuer from transacting any purchases and sales or sales and purchases of the issuer's listed securities within a period of less than six months. The Act makes any profit realized by

them recoverable by the issuer "irrespective of any intention on the part of such beneficial owner, director or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months."

Nobody compels a person to become a director, officer or principal stockholder of a corporation. When he does become a member of such class he does so voluntarily and "he accepts whatever are the limitations, obligations and conditions attached to the position."

As the United States Court of Appeals for the Second Circuit stated in *Gratz v. Claughton, supra,* at page 49:

> "* * * The section forfeits the profits because it forbids dealings in the shares. Nobody is obliged to become a director, or officer, or a 'beneficial owner'; just as nobody is obliged to become the trustee of a private trust; but, as soon as he does so, he accepts whatever are the limitations, obligations and conditions attached to the position, and any default in fulfilling them is as much a 'violation' of law as though it were attended by the sanction of imprisonment. * * *"

The District Court further stated in its opinion [R. p. 81] that "under the circumstances as outlined, the corporation should now be estopped to recover profits of a transaction which the corporation itself initiated and set up and which it (at least inferentially) assured defendants was valid."

In *Park & Tilford, Inc. v. Schulte* (C. A. 2, 1947), 160 F. 2d 984, cert. den. 332 U. S. 761, the defendants also sought to avoid judgment under Section 16(b) of the Act by raising a similar argument. In that case,

the defendants owned preferred shares of stock of Park & Tilford, Inc., which were convertible into common shares of stock. The defendants converted their preferred shares into common shares and thereafter, within a period of less than six months, they sold their common shares of stock. The corporation commenced an action against them under Section 16(b) of the Securities Exchange Act of 1934 claiming that the conversion by the defendants of their preferred stock into common stock constituted a "purchase" within the meaning and intent of the Act. The defendants argued that the corporation should not be permitted to profit from its own action because they were forced to convert their preferred shares of stock by reason of a resolution passed by the corporation calling all the preferred stock for redemption by a certain date.

The United States Court of Appeals, in rejecting this argument and directing judgment against defendants, stated (p. 988):

> "* * * Indeed, the contention that defendants were forced to convert is somewhat absurd, in view of the fact that since defendants controlled plaintiff they could have prevented the passage of the redemption resolution or rescinded it after it had been passed."

It is inconceivable that the District Court could have reasonably inferred that the facts of this case constituted an estoppel on the part of Consolidated from collecting the profits realized by the individual appellees herein as a result of their respective "short swing" transactions in its stock.

While it is true that Consolidated agreed to sell its stock to appellees at a stipulated option price, it certainly did not compel them to sell such stock within the six-month period.

The purchases by appellees of stock under their respective option agreements with Consolidated, in and of themselves, gave rise to no liability under the Act. It was the purchases *followed by the sales* within the six-month period which completed the cycle and gave rise to liability under the Act.

Before the passage of the Securities Exchange Act of 1934, Congress had recognized that speculations of "insiders" in corporate stock had been a source of "outrageous scandal."

The reasons for enacting the Act are fully and clearly set forth in Section 2 thereof. In its purpose the "Act is aimed as an integrated entity toward the reform of the security markets by control of speculation *and protection of the public* against trading based on inside information and other abuses in the market machinery." (46 Yale L. J. 624, 629. See *Smolowe v. Delendo Corporation, supra.*)

The main purpose of the Act is to protect the *investing public* by insuring that the securities exchanges of this Country shall maintain free, fair and open markets for the buying and selling securities.

Aside from the facts submitted which certainly negative any "estoppel" on the part of Consolidated to re-

cover the "short swing" profits from the appellees herein, the Courts have invariably held that where a right is granted "in the public interest to effectuate legislative policy, waiver of a right so charged or colored with public interest will not be allowed where it would thwart the legislative policy which it was designed to effectuate." (*Brooklyn Savings Bank v. O'Neil* (1945), 324 U. S. 697, 704.)

Thus in *Brooklyn Savings Bank v. O'Neil, supra,* the Court said at page 704:

> "It has been held in this and other courts that a statutory right conferred on a private party, but affecting the public interest, may not be waived or released if such waiver or release contravenes the statutory policy. *Midstate Horticultural Co. v. Pennsylvania R. Co.,* 320 U. S. 356, 361, 88 L. Ed. 96, 101, 64 S. Ct. 128; *A. J. Phillips Co. v. Grand Trunk Western R. Co.,* 236 U. S. 662, 667, 59 L. Ed. 774, 776, 35 S. Ct. 444. *Cf. Young v. Higbee Co.,* 324 U. S. 204, *ante,* 890, 65 S. Ct. 594, 57 Am. Bankr. Rep. (N. S.) 730. Where a private right is granted in the public interest to effectuate legislative policy, waiver of a right so charged or colored with public interest will not be allowed where it would thwart the legislative policy which it was designed to effectuate. * * *"

And in *Park & Tilford, Inc. v. Schulte, supra,* the United States Court of Appeals held that estoppel would not be tolerated nor allowed in an action brought under

Section 16(b) of the Securities Exchange Act of 1934. Thus in Footnote 1, on page 989, the Court said:

> "To the contentions that both Kogan and the Commission are estopped by previous positions taken, we think the answer clear that, as the former acts as fiduciary for other stockholders, the latter as representative of the public, no estoppel is permissible. Compare Federal Rules of Civil Procedure, rule 24(c), 28 U. S. C. A., following section 723c; *Young v. Higbee Co.,* 324 U. S. 204, 65 S. Ct. 594, 89 L. Ed. 890. * * *"

Finally, the District Court in its opinion [R p. 83] stated that "The hard rule of law might indicate that judgment should be rendered in favor of plaintiffs, but equity dictates that judgment should be in favor of the defendants herein."

It is respectfully submitted that in *Steinberg v. Sharpe* (C. A. 2), 190 F. 2d 82, the United States Court of Appeals for the Second Circuit had before it a case on all fours with the case at Bar involving the identical issues set forth in the present appeal.

In the *Steinberg* case, *supra,* the corporation, as here, granted options to "certain of its key personnel" to purchase shares of its stock at certain stipulated prices.

Shares of the corporation's stock were purchased by one Reuscher, an officer of the corporation, pursuant to two option agreements. The first agreement granted Reuscher the right to purchase 1600 shares at $8.75 per share in four blocks of 400 shares each. The second

agreement granted Reuscher the right to purchase 900 shares at $13.38 per share in four blocks of 225 shares each. Under each agreement, the option granted thereby became exercisable as to the first block one year from the date of the agreement, as to the second block two years from such date, as to the third block three years from such date and as to the fourth block also three years from such date but on condition that he had not theretofore sold any shares previously purchased by him under such agreement. Under each agreement, all rights expired four years after the date of the agreement. The options could be exercised by Reuscher only during the four-year period and only while he was in the corporation's employ or within a thirty-day period thereafter.

Within six months after Reuscher had purchased the shares of stock under his option agreements, he sold the shares of stock at a price in excess of the option price which he had paid therefor.

Suit was commenced under Section 16(b) of the Securities Exchange Act of 1934 to recover the profits realized by him as a result of his short swing transactions aforesaid.

The District Court, per Medina J. (now a Judge of the United States Court of Appeals for the Second Circuit), granted a judgment for the plaintiff directing the defendant, Reuscher to pay back his "short swing" profits to the corporation. In a well-reasoned opinion the District Court laid down the rule for determining the *cost* of the

shares of stock purchased under such option agreements, as follows (95 Fed. Supp. 32, 34):

> "Nevertheless, in determining the cost of the securities, the reasoning of the *Truncale v. Blumberg, supra,* would seem to require the inclusion of so much of the value of the option as represented long-term increment, to which the defendant was entitled pursuant to the option agreements by virtue of his continued services to the corporation.
>
> "This may be accomplished by holding the cost of the security to be the exercise price of the option plus the value of the option *on the day that it accrued* as fixed by the employment agreement under the terms of which it accrued. The latter figure will represent the amount of compensation which the corporation paid the defendant pursuant to its agreement, just as it did in the *Truncale* case. Adoption of this rule will preclude the type of evasion of the provisions of Section 16(b) described above."

The United States Court of Appeals for the Second Circuit, in affirming the judgment of the District Court, stated (190 F. 2d 82):

> "Judgment affirmed *on opinion below* 95 F. Supp. 32."

It is respectfully submitted that the District Court erred in failing to follow the principles of law set forth in the case of *Steinberg v. Sharpe, supra;* it should have entered judgments in favor of plaintiff and against appellees.

POINT III.

The Final Order of the District Court Denying Appellant, Pellegrino, the Right to Intervene for the Purpose of Appealing From Its Judgments Against Consolidated Should Be Reversed and Appellant's Motion to Intervene Should Be Granted, With Costs, and the Judgments of the District Court in Favor of Each of the Individual Appellees Herein Should Be Reversed and the Cases Should Be Remanded to the District Court Directing It to Enter Judgments in Favor of Consolidated Engineering Corporation and Against Appellees, William D. Nesbit, Hugh F. Colvin and James R. Bradburn.

Respectfully submitted,

KENNY & MORRIS,

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MORRIS J. LEVY,

Of Counsel.